International Journal of Human Resource
Management and Research (IJHRMR)
ISSN (P): 2249-6874; ISSN (E): 2249-7986
Vol. 9, Issue 1, Feb 2019, 53-60

IMPACT OF OPERATING EXPENSES ON LIFE INSURANCE PROFITABILITY IN INDIA

R. RADHIKA[1] & RAMESH KUMAR SATULURI[2]

[1]Research Guide, GITAM University, Rudraram Mandal, Sangareddy, Patancheru, Hyderabad, Telangana, India

[2]Research Scholar, GITAM University, Rudraram Mandal, Sangareddy, Patancheru, Hyderabad, Telangana, India

ABSTRACT

With the passage of IRDA Act 1999, Insurance Industry was opened to private companies and as of now, we have 24 Life Insurance Companies in India operating with a deployed capital of ~36625 crores with more than 20 lakh distributors and 32.5 crore in-force policies. Since 2000 we are in the 18th year of operations but still, more than a dozen companies are grappling with accumulated losses. A regulator has come with stringent guidelines on Expense Regulations and we are yet to see 100% compliance from companies in bringing down their Operating Expenses as per the guidelines.

KEYWORDS: OPEX, New Business Premium & TPI

Received: Nov 29, 2018; **Accepted:** Dec 20, 2018; **Published:** Jan 04, 2019; **Paper Id.:** IJHRMRFEB20195

Original Article

INTRODUCTION

Executive Summary

Privatization of Life Insurance Industry started in the year 1999 with the passage of IRDA act 1999. Now we have 24 Life Insurance Companies including the big brother LIC. We have completed 17 yrs. but still, companies are struggling with accumulated losses. Industry growth can be bifurcated into two periods viz. pre-2010 and Post 2010. Insurance companies were mainly focusing on business expansion and distribution building during Pre 2010 period. The main objective till that period was to grow business. Companies were setting up branches and also tied up with multiple banks and corporate agents. The industry registered more than double -digit growth during the said period. Top line growth was the focal point for the organizations. The regulatory spat between SEBI and IRDAI have given rise to a series of regulations with the focus on the capping of charges and expense regulations. Post 2010 the entire focus shifted to profitability or bottom line. Indian Insurance Industry follows NON-IFRS accounting process and this is at a disadvantage since the charges are front-loaded. This will make companies report losses with the new customer acquisition. Also, the distribution cost added to their woe.

While PHASE1 was dominated by scalability, PHASE 2 was driven by building efficiency. In order to build efficiency, companies started aggressively focusing on curtailing Operating Expenses. This situation remained tricky as most of the insurance companies who wrote new business add a huge business strain this is due to frontloading of entire accusations caused. The main objective of this article is to understand the

nuances of various parameters pertaining to opex and suggest ways and means reduce the expenses.

OBJECTIVES OF THE STUDY

- To understand the impact of Operating Expenses on Profitability
- To suggest measures in reducing Operating Expenses

DESIGN/METHODOLOGY/APPROACH

This paper is descriptive in nature which aims to understand the impact of Operating Expenses on the overall business of Life Insurance Industry and its profitability.

Related review of literature is structured around the key components of operating cost and expense regulation.

LIMITATIONS

- Limited time to study the measure adopted by companies in reducing OPEX
- Research is limited to reviewing the literature and best practices in Indian Life Insurance Industry

LITERATURE REVIEW

Dan Segal (2000)[1] in his research topic titled "An Economic Analysis of Life Insurance Company Expenses"` estimated the acquisition and maintenance costs associated with life policies as a function of the amount of insurance and number of policies of an insurer by estimating a cost function for our sample of insurers.

Ram Pratap Sinha (2013) [2] in his paper titled "Are Indian Life Insurance Companies Cost Efficient? Some Recent Empirical Evidence" opined that the cost efficiency of Life Insurance Companies in India between 2005 and 2010 exhibited significant fluctuations. Also, the cost efficiency is positively related to the ratio of premium collected through the traditional channel (i.e. individual agents) compared to nontraditional channels. This result has significant implications relating to the operational practices of the life insurance companies operating in India.

McKinsey's (2014)[3] edition of "Successfully reducing insurance operating costs – insights from McKinsey's Insurance 360o benchmarking" gave a comprehensive picture of cost developments in the insurance industry. The report opined that the root cause behind the persistent cost differences is business complexity, operating model, IT systems and performance management.

INTERPRETING OPERATING EXPENSES

Operating Expenses will include all recurring expenses incurred by the organization in continuing its business operations. Commission disbursed to agents will be treated separately. While OPEX will include all expenses, broadly can be categorized as follows.

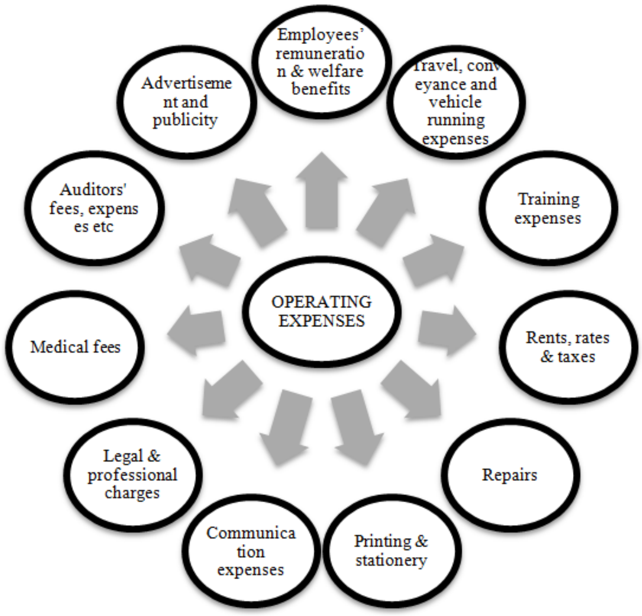


Figure 1

These are recurring in nature and some are direct expenses which are linked to sourcing of new business and other indirect expenses which will be incurred as fixed expense irrespective of new customer acquisition. We would not find any change in fixed nature expenses like employee salary cost, employee training and office rent irrespective of the business sourced. However will have few expenses like medical fees, policy bond printing which will proportionate to the amount of business sourced by the company.

Even though companies are allowed to factor the operating expense as part of product design within the stipulated ratios we still witness companies consciously attempting to curtail opex as this is the only way out for registering higher surplus.

REGULATORY GUIDELINES ON OPEX

As per the expense regulation 2016, the actual expense to allowable expense is up to 120 % till 2017-18. Effective 2018-19, this ratio is brought down to 100% where most of the insurance companies are struggling. Regulations have demarcated expense ratio bases the product mix and also the type of premium. According to expense regulation companies having greater than ten years vintage and products with a policy term of 10yrs and above would be allowed to spend up to 80% of the FYP written and 15% on renewal premium. Also, the ULIP regulatory guidelines 2010 have put a gap overall expenses at the product level. This has eventually restricted commission payout to distributors thus impacting the overall distribution network.

For the purpose of these Regulations, an insurer shall be deemed to be compliant with the limits of Expenses of Managements provided that the actual expenses of management are not above the Allowable expenses of management as under:

Table 1

SI. No	Financial Year	Percentage of Actual Expenses to Allowable Expense
1	2015-16* and 2016-17	120 percentage
2	2017-18	110 percentage
3	2018-19 and onwards	Not above 100 percentage

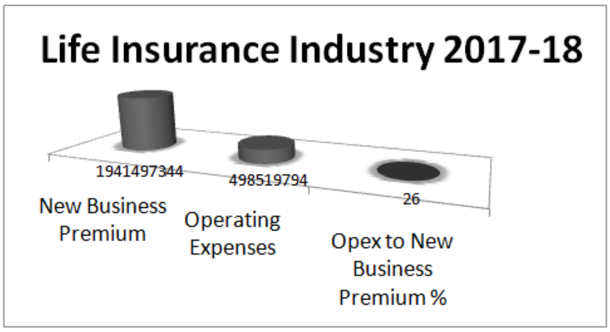
Source: IRDA Annual Report 2016-17

FAILURE TO COMPLY WITH REGULATIONS

While the overall limits are clearly defined IRDAI will expect Insurance Companies to comply with the stipulated guidelines. If we find Insurance Companies shooting up the expenses then companies are expected to submit a written explanation on breaching the expense ratio ratified by the actuary. IRDAI has kept at its discretion even to claw back the variable bonus of top management and also charge the shareholder account for the excess spending.

OPEX TO NEW BUSINESS PREMIUM

Let us understand in detail on the expense incurred by insurance companies on new customer accusations.

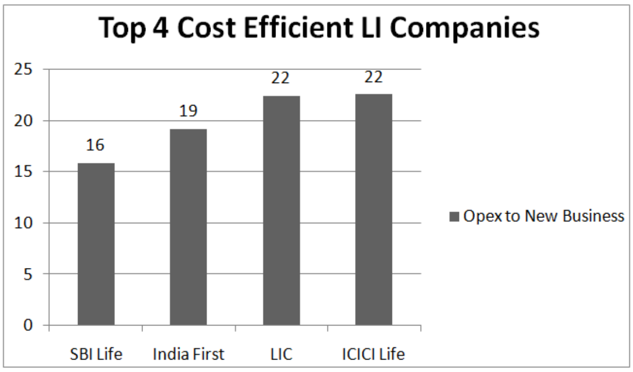


Source: Public Disclosures of Individual Life Insurance Companies

Figure 2

Industry average on the expense incurred at the time of procuring new business is at 26%. The industry had written a new business premium of ~1.94 lakh crores and spends an opex of roughly 49 thousand crores which is close to 26%.

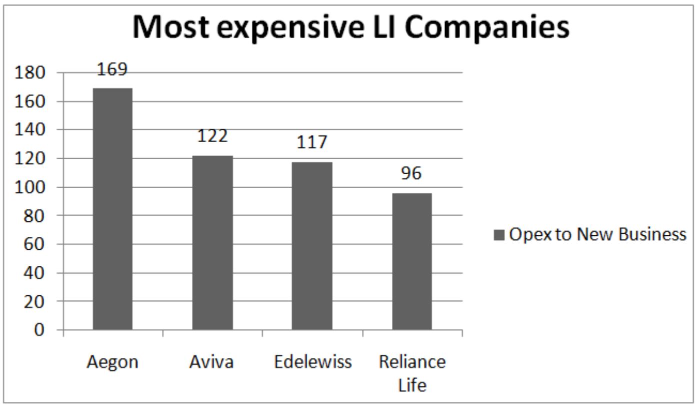
Out of 23 life insurance companies, the top 4 companies in terms of opex /new business premium ratio are SBI Life, India First, LIC and ICICI Prudential. Coincidentally except LIC, all other companies have bank assurance as the major channel to contribute business. Banks have promoted these companies. SBI life is the most cost effective of the all with New Business to OPEX at 16%.



Source: Public Disclosures of Individual Life Insurance Companies

Figure 3

On the other hand, we also have the bottom 4 companies who are struggling in terms of curtailing their OPEX and remained the most expensive in sourcing new business.



Source: Public Disclosures of Individual Life Insurance Companies

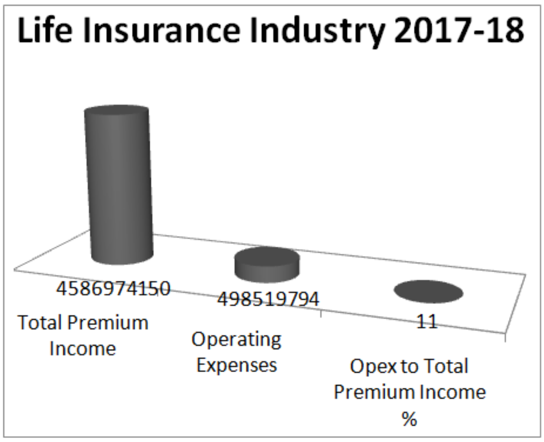
Figure 4

AEGON is leading the pack with 169% Opex to New Business Premium which means for every 100 Premium AEGON ends up spending 169 as OPEX. These companies are no way closure to the expense regulations of IRDAI. Expense regulation limit will include both the OPEX and also the commission which is distributed to agents.

OPEX TO TOTAL PREMIUM INCOME

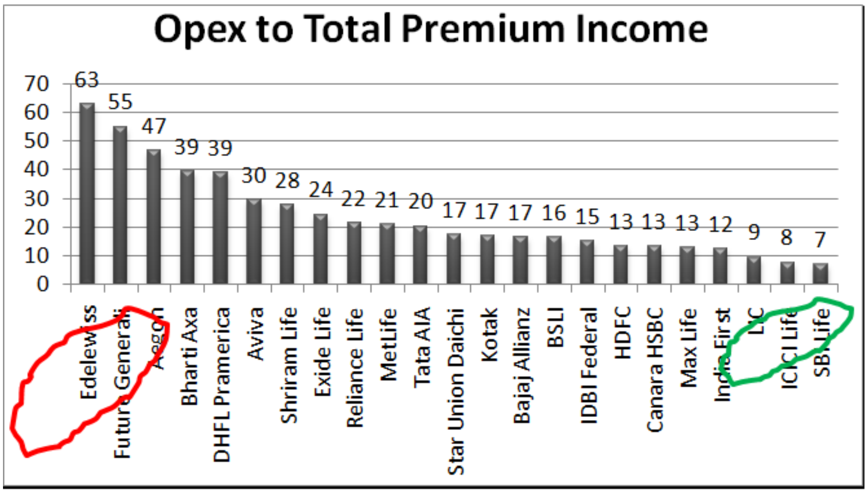
While insurance companies incur heavy expenses at the time of new customer accusations the only savior for them is the increasing renewal base. This will average out there expenses since most of the insurance companies who have a vintage of greater than 10 years have 60-65% as renewal premium on total premium income. Hence, companies started proactively engaging customers and build long-term relationship with them to better their persistency ratios.

Insurance Industry is at 11% on OPEX to Total Premium Income. The industry had a Total Premium Income of ~4.58 lakh crores with an OPEX spending of roughly 49000 crores. We are witnessing vintage companies having more cushions from the higher renewal base and hence a renewed focus on customer retention post a13th month.



Source: Public Disclosures of Individual Life Insurance Companies

Figure 5



Source: Public Disclosures of Individual Life Insurance Companies

Figure 6

At the individual company level, top 3 companies on OPEX to Total Premium Income are SBI Life, ICICI and LIC with SBI being the most cost-efficient company. On the other side Insurance Companies which have the highest OPEX are Edelweiss, Future Generali and Aegon.

ACCOUNTING PERSPECTIVE OF OPEX

From the accounting perspective, insurance companies go through a process called valuation bases which the company arrives at the surplus amount which in turn will get distributed between shareholders and policyholders. Hence, what we see at the year-end accounting is nothing but a surplus generated from the accounting perspective. Companies would continue to move a portion of surplus towards technical reserve in order to maintain solvency ratio stipulated by the regulator. Since commission disbursement is directly proportionate to sourcing new policies. The only area where insurance companies can focus is curtailing operating expenses. Companies focusing on reducing operating expenses will likely register a higher surplus. Insurance Accounting will go with the same basic principles of cash inflow and cash outflow. Outflow for an organization would primarily be a disbursement of commission, claims and operating expenses. While the first two are not fully in the hands of the company since the commission is dependent on

customer acquisition, retaining existing customers and claims basis the actuarial estimate the only area which the organization can actually create impact is curtailing operating expenses. If the OPEX is going to come down then the outflow is going to be less which translates into a higher surplus. Also from the ratios point of the view the efficiency of Insurance Company is measured in terms of spend of OPEX with the New Business Premium and Total Premium Income.

STEPS TO CURTAIL OPEX

Table 2

Employees' Remuneration & Welfare Benefits	Employee cost is the most important parameter in opex which accounts to 60-65% insurance companies have adopted various ways and means to reduce the employee cost. Companies started experimenting with variable channels wherein the cost is linked to the new customer accusations. Also, companies started incorporating higher variable pay in their CTC by linking their salary with minimum activity and productivity. Every company is trying to bring in more efficiency through optimal utilization of services. Companies are making a conscious effort to reduce the average cost per employee. The new trend which is catching up is to replace senior and vintage employees with fresh or low-cost employees.
Rents, Rates & Taxes	Companies are shifting from their existing spacious branches to small and low -cost branches. This is to reduce the expense incurred by insurance companies on high rents.
Travel, Conveyance, and Vehicle Running Expenses	Every company has an internal travel policy which defines employee travel plan bases is designation at business requirements. Most of the meets and product launches are carried using technology viz concalls, webinar, and skype.
Training Expenses	Insurance companies started hiring consultant trainers instead of a permanent employee to handle regulatory and product training. These consultant trainers are engaged on per day delivery thus saving huge expense on fixed costs and employing bigger training teams.
Printing and Stationary	With the advent of E-policy and Digi, Locker companies are creating awareness among customers thus saving cost on printing policy bonds.
Communication Expenses	We are witnessing overall drop on call charges by service providers. In addition to that employees are encouraged to have group plans wherein the cost would reduce further
Advertisement and Publicity	Insurance companies are utilizing social media to promote their products and services which are cost effective and also have a wider reach.
Medical Fees	Having a common repository on proposal health history is surely going to reduce the overall medical cost. While it is not fully operational companies may go away with medical checkup since the data is already available on the server.

CONCLUSIONS

Insurance Companies are heavily depending on Digital revolution and analytics to trim their operating costs. We are seeing companies adopt automation in all fields including sales, operations, underwriting, and claims process which in turn is leading to a save on OPEX spending. We have applications aiding companies to auto underwrite cases without much human intervention. This in turn, is helping write quality life at a lesser cost. Telematics and wearables are throwing us enough big data to caution the customer before any eventuality and also provide information on customer habits and lifestyle. Companies do not have large structure training departments to train their employees and distributors.

E-learning has its way and also product launches happen through regular concalls, webinar, skype etc. which are

quick, effective and cost-efficient. Sales automation have come a long way with Digital proposal form wherein customer data is extracted from server and data provided to underwriter and operations who simultaneously will initiate the underwriting process.

Companies have established digital boards and allocated budget for technological innovation. These initiatives are expected to curtail operating expenses by more than half, build cost efficiency and augment scalability as well.

REFERENCES

1. *Retrieved from http://shodhganga.inflibnet.ac.in/*
2. *Retrieved from http://www.lifeinscouncil.org/about-us/industry-overview*
3. https://s3.amazonaws.com/academia.edu.documents/51861634/Madhuri_Blackbook.pdf?AWSAccessKeyId=AKIAIWOWYYGZ2Y53UL3A&Expires=1546414340&Signature=UoVwHGX7Ap13EzykyNIILYm3Rxc%3D&response-content-disposition=inline%3B%20filename%3DA_COMPARATIVE_STUDY_OF_PUBLIC_AND_PRIVAT.pdf
4. *IRDA HANDBOOK 2016-17*
5. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2838829
6. *Retrieved from https://www.irdai.gov.in*
7. *Retrieved from http://www.policyholder.gov.in/default.aspx*
8. *IRDA Annual Report 2016-17*

APPENDIX 1.0

Competitor	New Business	Renewal Premium	Total Premium	Opex	Opex to New Business	Opex to Total Premium Income
Edelewiss	3424620	2957976	6382596	4005272	117	63
Future Generali	5823492	4099441	9922933	5458144	94	55
Aegon	1470481	3841586	5312067	2478604	169	47
Bharti Axa	7308631	9535283	16843914	6649431	91	39
DHFL Pramerica	14556810	3887782	18444592	7201688	49	39
Aviva	3255706	10186458	13442164	3968879	122	30
Shriram Life	8103329	6867038	14970367	4161238	51	28
Exide Life	7599008	17719858	25318866	6166644	81	24
Reliance Life	9156196	31537511	40693707	8767196	96	22
MetLife	14270806	25264302	39535108	8246026	58	21
Tata AIA	14884172	26745329	41629501	8448833	57	20
Star Union Daichi	7007248	10822818	17830066	3096770	44	17
Kotak	34042137	31944585	65986722	11190799	33	17
Bajaj Allianz	42911387	32872359	75783746	12578740	29	17
BSLI	26628030	32402003	59030033	9714271	36	16
IDBI Federal	8330259	9502148	17832407	2674114	32	15
Total Private	594780384	809961710	1404742094	197091863	33	14
HDFC	113496093	122148040	235644133	31718450	28	13
Canara HSBC	12277448	15533121	27810569	3720876	30	13
Max Life	43485906	81523014	125008920	15913882	37	13